Internal Revenue Service

Number: **201223014**
Release Date: 6/8/2012

Index Number: 167.22-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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Refer Reply To:
CC:PSI:B06
PLR-143240-11

Date:
March 07, 2012

LEGEND:

Taxpayer	=
Parent	=
State A	=
State B	=
Commission A	=
Commission B	=
Commission C	=
Project	=
Date A	=
Director	=

Dear :

This letter responds to Parent's request, made on behalf of Taxpayer, dated October 14, 2011, for a ruling on the consequences under the normalization provisions of Taxpayer's inclusion of certain costs in rate base as described below.

The representations set out in your letter follow.

Taxpayer is an integrated public utility incorporated and headquartered in State A. It is a wholly-owned subsidiary of Parent, and is included in the consolidated federal income tax return of Parent. Taxpayer is principally engaged in the generation and distribution of electricity and the distribution and transportation of natural gas in State A

and State B. It is subject to regulation by Commission A, Commission B, and Commission C with respect to the terms and conditions of service including the rates it may charge for its services. With respect to the jurisdiction of each of the commissions, Taxpayer's rates are determined using a "rate of return" basis.

Taxpayer placed the Project in service on Date A. Commission A had preapproved a level of construction costs with respect to the Project and had provided an overall "cost cap" for the Project. If amounts were expended in excess of the cost cap, such amounts would only be recoverable if Taxpayer was able to demonstrate that such amounts were reasonable and prudent. Taxpayer exceeded the cost cap but was able to demonstrate to the satisfaction of Commission A, that the amounts in excess of the cost cap were reasonable and prudent. In ratemaking for recovery of costs related to the Project, Commission A allowed full recovery of all costs associated with the Project as well as including calculation of the accumulated deferred income taxes on the total cost of the Project in rate base. However, Commission A provided for a zero rate of return on those costs that exceeded the cost cap.

Law and Analysis

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(1)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 168(f)(2) of the Code provides that the depreciation deduction determined under section 168 shall not apply to any public utility property (within the meaning of section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, section 168(i)(9)(A) requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period

used to compute its depreciation expense for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that-would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

In order to satisfy the requirements of §168(i)(9)(B), there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. Here, the entire cost of the Project is included in rate base and in the computation of regulatory depreciation expense. In addition, the accumulated deferred income taxes are calculated with respect to the total cost of the Project. Thus, the regulatory treatment of costs for Project satisfy the consistency requirements of §168(i)(9)(B). While Commission A did not allow Taxpayer to earn a return on that portion of the cost of the Project that exceeded the cost cap, §168(i)(9)(B) does not require that every element of the cost of a project included in rate base earn a uniform rate of return. Thus, the regulatory treatment by Commission A in this situation satisfies the requirements of §168(i)(9)(B).

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above. In particular, orders concerning this matter finalized by any of the Commissions after the date of this ruling are not necessarily subject to the same analysis as those considered above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
(Passthroughs & Special Industries)